U.S.-U.S.S.R. Trade and the Whipsaw Controversy

Excerpts from meeting March 30, 1977 . . .
Advisory Committee on East-West Trade

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U.S. DEPARTMENT OF COMMERCE
Domestic and International Business Administration
Bureau of East-West Trade

Foreword

It has been argued frequently that certain unique aspects of the U.S.-U.S.S.R. trade relationship dictate a need for a special role for the U.S. Government — a role it does not play in trade with other countries. This perceived need for an enlarged governmental involvement has arisen largely from an assertion that U.S. firms inherently are at a bargaining disadvantage when negotiating with Soviet foreign trade organizations and frequently are "whipsawed" into unfavorable transactions.

Because of its implications, this "whipsaw theory" of U.S.-Soviet trade was examined and discussed at the March 30, 1977, meeting of the Advisory Committee on East-West Trade. This publication is based on the committee's discussion and is being made available to encourage a greater understanding of, and dialogue on, an important issue.

The text has been edited for content and clarity with the approval of the participants. Background materials prepared to support discussion have been inserted where appropriate. Also, to provide additional information, relevant portions of a recent academic study of "whipsawing" are reprinted in an Appendix.

The Bureau of East-West Trade would, of course, welcome additional comments and views on this subject.

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Introduction

The Secretary of Commerce established the Advisory Committee on East-West Trade on February 11, 1974. The committee is composed of approximately 20 representatives of business and industry, public interest groups, and the academic community who are appointed by the Secretary of Commerce.

The committee functions solely as an advisory body and advises the Deputy Assistant Secretary of Commerce for East-West Trade on ways to facilitate the expansion of U.S. trade with the U.S.S.R., Eastern Europe, and the People's Republic of China.

Among its other functions, the committee provides a forum for business, the academic community, and government to discuss problems and issues in the field of East-West trade, and may identify and make recommendations on current and proposed government policies and programs in this area.

Advisory Committee on East-West Trade

Andrew J. Beck, Textron, Inc.
Erskine C. Chapman, Caterpillar Tractor Co.
William J. Fleming, Combustion Engineering, Inc.
Walter Galenson, Cornell University
G.M. Garbarino, Westinghouse Electric Corp.
George B.E. Hambleton, Pan American World Airways, Inc.
Robert J. McMenamin, International Harvester Co. (Chairman)
Kenneth Lipper, Salomon Brothers
Jerome Ottmar, Amtel, Inc.
*Tino Perutz, Tino Perutz Associates
James A. Petrie, Jr., Pullman Kellogg
Georges R. Potter, Eutectic Corp.
*Marshall D. Shulman, Columbia University
Julian M. Sobin, International Minerals and Chemical Corp.
Donald E. Stingel, Pullman Swindell (Vice Chairman)
Alfred R. Wentworth, Chase Manhattan Bank, N.A.

* Denotes member not present at the March 30, 1977 meeting.

Other Participants in the Discussion

Arthur T. Downey, Deputy Assistant Secretary of Commerce for East-West Trade

Allen J. Lenz, Director, Office of East-West Policy and Planning, Bureau of East-West Trade

William F. Kolarik, Jr., Office of East-West Policy and Planning, Bureau of East-West Trade

Valentine Zabijaka, U.S.S.R. Affairs Division, Office of East-West Country Affairs, Bureau of East-West Trade

David M. Jones, Partner, Pierson, Jones and Nelson, Attorneys at Law

Lewis Lamm, Consultant, Trade Development and Licensing, Clark Equipment Company

Summary

Drawing on a discussion paper entitled "U.S.-Soviet Trade and the Whipsaw Controversy" distributed to committee members, William Kolarik of the Bureau of East-West Trade briefly described the following theory of whipsawing:

Since a U.S. company is required to enter the Soviet market through monopsonistic foreign trade organizations (FTOs), the firm is tempted to make concessions to win large contracts away from its competitors. Thus, in theory, an FTO can "whipsaw" a U.S. company into what have been termed "giveaway sales."

Kolarik pointed out that this line of thinking was reflected in a 1976 General Accounting Office study of East-West trade.* The study recommended increasing U.S. Government involvement in the U.S.-Soviet trade process, perhaps by formulating support guidelines for firms or even becoming a participant in contract negotiations. Kolarik concluded that although this report has been read widely in government circles, its analysis has not been challenged, and he questioned whether committee members actually had found whipsawing to be a problem.

In the discussion that followed, an emphatic denial of whipsawing as a difficulty in dealing with the Soviet Union emerged as the consensus of the business community as represented on the committee. Business members similarly rejected the GAO's recommendations for a direct government role in FTO-U.S. company negotiations. All were of the opinion that FTOs do not have any unusual bargaining clout, and that dealing with the Soviet Union is no more problematic than dealing with any other country. They added that the Soviets are more experienced in stiff negotiating tactics, but that intensive negotiation is not necessarily whipsawing.

Some members felt the committee was dignifying a non-problem by addressing committee attention to whipsawing. However, committee member Walter Galenson took the lone dissenting position, stating that he felt there *is* a problem. Galenson prefaced his argument by noting that he talks to a different group of people than most of the businessmen

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* *The Government's Role in East-West Trade—Problems and Issues* (GAO February 1976, ID-76-13A).

who were present and finds substantial concern about this issue in organized labor and the academia.

Galenson then drew a distinction between the "micro" benefits of a company's dealings with the Soviet Union, and the "macro" interests of a country in dealing with the Soviet Union. While he conceded that those businesses represented on the committee might be doing quite well, in the aggregate and as a nation, U.S. interests might be suffering.

Galenson also pointed to the contradiction he felt was inherent in the committee members' desire to have government participation in the areas of financing and legislative support, and yet no government involvement in trade.

In refuting this point of view, committee members repeated their denials of being whipsawed into marginal or unprofitable contracts. One committee member added that on the matter of government support for financing, U.S. firms only want to equalize their position vis-a-vis foreign competitors. Another committee member pointed out that Walter Galenson was giving the question a much broader context, encompassing issues beyond the narrow concern of whipsawing. He agreed that the committee recognizes there are other questions in the total picture of East-West trade, but that the focus of the discussion was restricted to whipsawing.

Robert McMenamin then summed up the consensus of the businessmen on the committee, and asked Arthur T. Downey, Commerce Deputy Assistant Secretary for East-West Trade, and committee members what steps might be taken to express this view to a wider audience. A consensus developed among committee members leading to the recommendation that a monograph on whipsawing be prepared by the Bureau of East-West Trade from a transcript of the preceding discussion. The committee also requested the Bureau to develop a brief summary of the transcript, and asked that these materials be given wide distribution and be forwarded to the General Accounting Office.

Whipsawing In Soviet-American Trade

WILLIAM KOLARIK: I am going to speak briefly about what I call the "whipsaw theory" of U.S.-Soviet trade, and I have written a discussion paper on this topic which has been provided to the committee. The committee also has been given copies of a handout entitled "Whipsawing in Soviet-American Trade," containing a number of items to which I will refer in the course of my talk. First, I would like to review briefly the high points of my discussion paper on whipsawing, in which I pose a series of questions.

However, I would like to qualify my remarks in two respects: First, I am going to limit my comments on whipsawing to U.S. trade with the Soviet Union only. I will do this because those who view whipsawing as a problem generally see the U.S.S.R. as the most troublesome in this regard. The U.S.S.R. is singled out because of the large size of its economy and the correspondingly larger volume of foreign trade that the country conducts with the West.

Also, I will confine my remarks to nonagricultural trade with the U.S.S.R.; that is, U.S. exports of manufactured goods and technology. I think that trade in agricultural commodities represents a special situation which is perhaps best treated in another discussion.

To begin, what is whipsawing? What is the meaning of this term? Most simply, I think we can define whipsawing as the ability of a large buyer to play off potential sellers against one another to obtain maximum price breaks or other contractual concessions.

Proceeding from that very simple definition, what then is the "whipsaw theory" of U.S.-Soviet trade? As most of you probably know already, it has been alleged that Soviet foreign trade organizations (FTOs) are ideal instruments for effectively whipsawing U.S. companies. It is charged that Soviet FTOs have unusual market power which has enabled them to take advantage of U.S. firms in contract negotiations by playing one U.S. firm against other U.S. firms or against foreign competitors.

What are the sources of FTO clout? Supposedly, FTOs have unusual market power. Why? Two reasons usually are cited: First, an American company wishing to sell a given product to the U.S.S.R. can only enter the Soviet market through the FTO specializing in that particular product. So, in essence, the FTO is a monopoly buyer for the entire Soviet Union for that product.

The second reason — and this is interrelated with the first — is that as national purchasing agencies, FTOs often buy in volume, and it is alleged that the bigger the order at stake, the more tempted the U.S. firm is to make concessions to win the contract.

That is a quick review of the "whipsaw theory" of U.S.-Soviet trade. I would like now simply to sum up by saying that many people, including a considerable segment of the public and quite a few government officials, have reached the conclusion that because the free market only exists on the seller's side of the transaction, American companies often find themselves at a severe bargaining disadvantage relative to Soviet foreign trade organizations. It is said that American companies, eager to land large contracts and enticed by the prospect of penetrating new industrial markets, are being whipsawed into giveaway contracts on both products and industrial know-how sold to the Soviet Union.

So in conclusion, we can say that if one accepts the "whipsaw theory" of U.S. trade with the Soviet Union, then trade with the U.S.S.R. essentially becomes a "one-way street."

This kind of thinking has turned up in government circles, and what I would like to do now is point to some excerpts from the GAO report which are contained in Section A of today's handout. We think we have extracted some interesting passages, which highlight the GAO's acceptance of the whipsaw theory of U.S.-Soviet trade. Very quickly, I would like to read some passages which refer to the whipsawing of U.S. companies.

[Reprinted below are passages from *The Government's Role in East-West Trade—Problems and Issues* (GAO February 1976, ID–76–13A) which is the U.S. General Accounting Office report referred to by William Kolarik during his presentation. Italics represent key passages emphasized by Kolarik.]

". . . , The United States has not achieved commercial reciprocity in trade with the Soviet Union. *This imbalance in commercial benefits is attributable to the basic differences between the two economic systems. A multiplicity of corporate entities, whose motivations are often subnational and parochial in character, confronts a buyer that bases all purchasing decisions on its national interests. This basic incompatibility in systems limits the negotiating leverage of U.S. firms* and compromises the U.S. Government's ability to support commercial interests or to protect broad national interests." [GAO Report, p. 56]

"United States-Soviet trade is beneficial for both parties, but *negotiating advantages accruing to the Soviets* distort the commercial and national balance of benefits." [GAO Report, p. 61]

". . . *the Soviets enjoy superior negotiating leverage because of their position as a single buyer with many competing sellers. The Soviet ability to manipulate this competition for sales and the inherent nature of*

their trading practices makes the tendency for aggregate benefits in their favor." [GAO Report, p. 60]

"*The literature on 'monopsony' firmly establishes the superior negotiating leverage of the single buyer . . .*" [GAO Report, p. 60]

"The principal sources of commercial imbalance are the centralization of the Soviet economic system and the superior buying power this system generates. *The Soviet trade regime presents some unique and sometimes insoluble problems for U.S. Government and company negotiators.*" [GAO Report, p. 55]

"*. . . the secrecy and centralization with which Soviet purchasing plans and decisions are made places U.S. firms on the defensive.* Although the broad outlines of Soviet economic requirements are clear, the Soviets buy what and when they want, not necessarily what they need in any economically predictable sense." [GAO Report, p. 55]

"*. . . discrepancy between market access and reciprocity is a result of the superior buying power of Soviet foreign trade organizations. This basic element in Soviet trade practice is likely to limit the corporate and national benefits accruing to the United States.* And it is this capability which, despite prolonged negotiation with the Soviets preceded by extensive U.S. Government study, has been undiminished by either reform of the Soviet regime or *more active and supportive U.S. Government participation in the relationship.*" [GAO Report, p. 56]

"*The implications of Soviet buying power for U.S. commercial and national interests are significant. At the enterprise level, the Soviets have successfully manipulated competition among U.S. and other foreign manufacturers and banks.* As a result, there is evidence that *at least some U.S. firms have not achieved their normal levels of profitability. The Soviets have also stimulated competition among certain U.S. high-technology companies in order to maximize the uncompensated transfer of technology,* some of which has been strategically sensitive." [GAO Report, p. 56]

"*The East-West Trade Policy Committee recently concluded that the U.S. Government should consider significantly different procedures for regulating trade with Soviet organizations than for trade with most other nations.* The Committee also concluded that aside from cash sales, the overall benefits of a proposed major transaction were heavily weighted in the Soviet's favor." [GAO Report, p. 60]

"*. . . the basic response to the imbalance in commercial benefits must come through more active U.S. Government participation in the trade relationship. The present lack of Government control over the activities of U.S. firms precludes withholding potential benefits in exchange for improved commercial practice. The lack of direct Government support and advice to U.S. firms participating in contract negotiations leaves unimpaired the Soviet ability to manipulate the competition. Finally, the*

lack of Government control over U.S. company commercial negotiations compromises the Government's ability to fully protect U.S. national interests . . ." [GAO Report, p. 59]

". . . the major thrust of *our recommendations for Government involvement is to protect U.S. national interests and modify the present Government-industry relationship to permit more direct and effective support for commercial interests in the Soviet market.* These are significant reasons for Government involvement. Indeed, the executive branch's own recent initiative in negotiating a long-term grain supply agreement with the Soviets gives recognition to the legitimacy of the thrust of our recommendations." [GAO Report, p. 61]

"Our recommendations are designed to increase commercial and diplomatic returns from future trade by . . . *increasing the degree of executive branch involvement in U.S. company-Soviet commercial negotiations in order to fully protect U.S. national interests and to permit more direct and effective support for commercial interests.*" [GAO Report, pp. 59–60]

"The Secretary of the Treasury, in his capacity as Chairman of the East-West Foreign Trade Board, should . . . review all transactions involving . . . national interests, such as commodity price stability and supply, technology seepage and security of investments, as well as transactions requiring credit or export licenses. Criteria for involvement could include size of transaction and credit, nature of product or technology, number of firms competing, and structure of the transaction (product payback, for example). *The intensity of involvement could vary from indirect guidelines for the firms, to observer status at commercial negotiations, to direct negotiations with Soviet officials, to disapproval of the transaction.*" [GAO Report, p. 66]

RESUME DISCUSSION BY WILLIAM KOLARIK: The first point I want to make is that the GAO report accepts the whipsaw theory of U.S.-Soviet trade and proposes profound changes in the way this country conducts international business.

Second, the report has been widely circulated in government circles and a lot of people have seen it.

Third, the conclusions contained in the report have not been challenged in a meaningful way.

Personally, I am not convinced that whipsawing is a major problem in U.S.-Soviet trade. The only evidence of the whipsaw theory that I have seen so far consists of references to textbook micro-economic theory and a few isolated instances where whipsawing is said to have been effective on U.S. firms.

I do not think that on this kind of evidence we have the basis for major changes in U.S. Government policy in international trade. So what I am asking today is whether whipsawing really is the problem that the

GAO report says it is, or does the GAO overstate the extent of the problem?

In preparation for this meeting, we posed a series of questions on whipsawing to the committee members. In response, we received a number of written replies, which are outlined in Section B of today's handout. I would like to summarize very quickly the views which have been submitted anonymously by committee members.

[Reprinted below is a summary of written replies to questions on whipsawing submitted to committee members prior to the meeting of March 30, 1977.]

Question 1

Have the Soviets (or other Communist country "FTOs") really been able to whipsaw U.S. companies effectively? If whipsawing does occur, how widespread is the problem? Is it unique to U.S. trade with Communist countries, or does whipsawing occur in other international or domestic transactions?

Answer [Executives 1 & 2]

"The key word, obviously, is 'effectively.' That the Soviets try to use the whipsaw to force prices down is unquestionably true.

"But is that in itself significant?

"In international competition, whipsawing is an often encountered and acceptable business practice. The basic Soviet insecurity in dealing with the Capitalist West may result in more consistent use of the technique than would characterize another Western entity, for example. But of all the small and medium-sized (up to $10 million) contracts with the U.S.S.R. in which I have participated, I have yet to see our company whipsawed into a loss or break-even position.

"Whipsawing is probably less used domestically than in international markets. Domestic business partners rely more on knowledge and trust gained through long standing relationships. There is no reason to doubt that greater knowledge of each other would eventually reduce the Soviet reliance on whipsaw tactics with their business partners.

"In general, the whipsaw is just another technique in the repertoire of the experienced purchasing negotiator, and is viewed as such by an experienced selling negotiator. The whipsaw can be best countered by:

a) Knowing your customer and your market.
b) Knowing your competition, and his current condition.
c) Being sensitive to the current political and macroeconomic realities which could impinge on your deal.

"All of a), b), and c) above are axiomatic for any seller in a market with which he has had considerable experience. They are equally helpful

in the Soviet market. That they are more difficult to achieve is both true and irrelevant to this discussion."

Answer [Executive 3]

". . . Our commercial transactions are always extremely competitive and we do not feel that the Soviet Union's purchasing practices offer a more significant problem than in many of the other areas of the world in which we do business. Somewhere along the line, each manufacturer must make his own determination as to what constitutes a good business transaction for his own particular company—regardless of what whipsawing is taking place . . ."

Answer [Executive 4]

"Frankly, I don't understand how this so-called whipsaw controversy has developed. In our experience, the fact that the Soviets represent a non-market economy doesn't make dealing with them any different from dealing with any other major customer, such as one of the international oil companies. We almost always have competition, and with rare exceptions, we find the customer comparing proposals, be it in Eastern Europe, Western Europe, or in the United States.

". . . Just as any other big customer, they (the Soviets) would undoubtedly tell each of us we were sky high, etc. And, of course, they could play the German financing terms against what our . . . terms were and we would hear that in one case there would be a limit of 7 or 8 percent on the escalation clause, whereas the other group wanted a 10 or 12 percent escalation, etc. In the end, our group got the job and we think at a slightly higher price than the Germans would have accepted because our technology seemed to be preferred, and we also feel that a certain amount of loyalty has developed because of a satisfactory relationship of several years' standing.

". . . I do not know of any case where design specifications provided by one company were used improperly in getting bids from a competitor. Any customer is going to incorporate any new ideas he gets from a proposal. I do have the opinion that license agreements which we have arranged for a plant of a given capacity have been adhered to and if an addition or a new project comes up, the Eastern countries are willing to include an additional royalty for that extra capacity unless it has become old technology. And we do not know of any of these countries having tried to copy a plant which we have built.

"The 'wear them down' negotiations certainly are true. I think, however, the delays are not just for negotiating purposes but rather because you're dealing with a highly bureaucratic organization on the other side. In our projects we normally think we will work from 1 to 3 years from inception to final contract. I could add facetiously that if an American com-

pany had as its negotiating partner some U.S. Government agency, I can see even greater delays!"

Question 2

To what extent, if any, does lack of Most-Favored-Nation (MFN) status and Eximbank financing for the U.S.S.R. make U.S. companies more susceptible to whipsaw tactics than European and Japanese competitors?

Answer [Executives 1 & 2]

"Lack of MFN and Eximbank financing often cause U.S. companies to be eliminated from the competition before whipsawing has an opportunity to occur, or to go to offshore production via a European or Japanese licensee or subsidiary. My experience indicates that they are not so fearful of whipsawing and have learned to cope with it.

"If the seller has profit as his motive for seeking Soviet business, and refuses to compromise that goal, which is normally the case, whipsawing cannot be harmful to trade and economic growth. If the U.S. fails to get its share of the business and profits from the Soviet market, the blame will not be attributable to whipsawing or other Soviet tactics, but rather to the abysmal failure of the United States Government in providing the financing and other facilitating factors which would make us competitive with the Japanese and other Western nations."

Answer [Executive 4]

"I don't know where the GAO gets its information, but I personally am not aware of facts that would lead to the conclusion that American companies need to be 'protected'. American companies, in my opinion, do need governmental help in the way of MFN and Eximbank credits if we are going to compete with the countries of Western Europe and the Japanese.

"I certainly don't think in most cases that it would be practical for the U.S. Government to have a 'chosen instrument'. First of all, they would be setting up a lot of chosen instruments, which in competition with Western Europe and the Japanese, would lose a lot of jobs, and the Government would soon get tired of 'choosing'. And I can't believe that in our way of doing things, our Government would or could subsidize a chosen instrument to help them get business. The only way the Government can help is by providing competitive credit terms, removing the emotional stumbling block of no MFN and perhaps making it clear that antitrust laws are not intended to prevent all joint bidding by U.S. firms."

Question 3

Are some U.S. companies inherently more susceptible than others to whipsaw tactics? If so, why? Are companies dealing in comparatively stable conventional technologies more vulnerable to whipsawing than their counterparts who market high-technology products/services which

are more subject to rapid innovation-induced commercial obsolescence? Are large, diversified multiproduct companies better able to cope with FTO market power than the smaller firm with a limited product line? Because the U.S.S.R. has a well-documented penchant for buying the best, are "name" firms which have earned the reputation as world leaders in their respective product lines in a position to nullify FTO leverage?

Answer [Executives 1 & 2]

"Yes, of course, the high technology items (where competition is limited) are less susceptible to whipsawing, but it has yet to be proven that this tactic works any better than the other conventional bargaining tactics which can be applied equally well to the high and conventional technology items.

"The size and diversity of a firm may be a factor in the negotiation only insofar as the larger firm may have more talent and depth at the bargaining table, as well as at the technical discussions which precede the bargaining. The latter can establish a 'demand' for the product, and thereby make the commercial negotiations a bit easier. Name firms, and products with a wide reputation are, if anything, subjected to greater bargaining pressure in the first few purchases than the average firm or product. This is a result of the Soviets' natural aversion to 'paying for a name'."

Question 4

In general, has the immediate and/or prospective dollar value of Soviet contracts dangled before U.S. companies frequently been large enough to provoke unusually cutthroat competition among potential vendors? Do U.S. negotiators give credibility to Soviet inferences of millions of dollars in lucrative future business if, as a gesture of goodwill, the American company will settle for a break-even contract on the first deal?

Answer [Executives 1 & 2]

"It is often alleged that American companies have consciously accepted break-even deals with the U.S.S.R. in order to win future contracts. In 5 years of dealing with the Soviets, I have yet to see an American company intentionally sign a break-even contract. I have seen several instances, however, in which American companies were summarily dismissed from negotiations for having offered indefensively high prices (by competitive standards). These high prices were defended to me in private as having been set to include huge contingencies to protect against whipsawing, as well as other perceived threats such as piracy of technology, disregard of royalty or territorial agreements, etc. It is conceivable that the fear of whipsawing causes more U.S. companies to be unsuccessful than the whipsawing itself."

Answer [Executive 4]

"The point is made of inferences of sizable and lucrative future business, conditional upon a gesture of good will on an initial contract. Again, there is always the tendency for a seller to want to get his foot in the door in hopes of future business, and I don't suppose these countries represent any exception. As a matter of fact, our first large contract didn't turn out as well as we had hoped, but we feel it was very worthwhile because it has helped us firm up a relationship which makes subsequent contracts easier. We know the people now, and they know us and have confidence in us, etc."

RESUME DISCUSSION BY WILLIAM KOLARIK: What I would like to do now is pose some additional questions to committee members, and perhaps discuss whipsawing in greater detail.

I should point out that the written responses which we received to our questions represent a limited number of committee members. What I would like to know is whether any of you feel differently?

In particular, I think that we need to address several additional questions which are not contained in today's handout:

First, to what extent does the capacity for whipsawing depend on the availability of alternative world markets for the seller's products? It is alleged that FTOs represent a monopsony. But while this may be true for the Soviet Union, the Soviet Union is not the only buyer in the international marketplace. There are alternative markets for U.S. products. To what extent does this variable impinge on the effectiveness of whipsawing?

Second, are U.S. firms more susceptible to whipsawing during periods of recession, when domestic markets are depressed? And if companies are more vulnerable during such periods of recession, have the negative aspects of transactions with narrow profit margins been overstated? That is, even if a company in the midst of a recession signs a break-even contract, is that necessarily bad, or are some positive benefits generated in terms of preventing layoffs, meeting payrolls, and perhaps even helping some firms to avoid bankruptcy?

At this point, I would like to open it up to discussion, and ask if whipsawing is really a problem. Also, what do you think about the GAO report and its recommendations for U.S. Government action?

ROBERT MCMENAMIN: Bill, I am going to, if I may, speak as a member of the committee and not as its Chairman. I have a counter to whipsawing which I would like to throw out and hope that others here who may have had similar experiences will express their views.

In my view, and in the view of many people I have talked with — and this is not only in the case of the Soviet Union, but is also true of other socialist countries — there is an element of pre-selection on their part in choosing a supplier, and this element of pre-selection often is based on

studies they have done of the technical capabilities of the firm, previous contracts that they may have had with that company, and their reaction to the company people who are involved. Furthermore, I think that from their perspective, it is conditioned by the possibilities for an ongoing relationship that could result from their dealings with a particular company.

Although we are pretty well-known as a company and by the product lines we represent, our experience has been that in the Soviet Union and other countries, there have been cases where, to my sorrow, we were not the preselected entity, and where we heard about a transaction after it had occurred. Similarly, I believe there are some cases where our company has been favored and a competitor has not been involved.

I would, therefore, like to offer as a direct counter to whipsawing this phenomenon I have described — the element of preselection, and ask in your various comments if some of you would bring out your own experience in that regard.

WILLIAM FLEMING: I had a very interesting experience in that regard some years ago. One of the East European countries was interested in buying some equipment — it was an important purchase — and our company was preselected. Their rationale was that even if they threw this job open to competition, they probably would settle at a price pretty close to what they were able to buy it for from us. More important to them at that time, they felt, was to give the limited amount of business they had to one company, which they felt would help them in their relationships in the United States. Now, this was some time ago, but they felt that a friend in court was more important to them than dividing their business and ending up without a particular friend. The country at that time was looking for MFN, they were dealing with just a few companies in the United States, and I think their reasoning was along the lines of your example: Give the business to one company and hope for intangible benefits.

ROBERT MCMENAMIN: How about the bankers? Are they whipsawed?

ALFRED WENTWORTH: Well, of all the bankers here I will open up, if I may, and somebody could follow. I have had whipsawing attempted. If you mean intensive negotiations, then yes, we have been tempted to cut our own throats. I have had them go so far as to say to me, "Al, you are an eighth (of a percent) over," and I say, "that is where we are going to stay," and then they come back and take the deal.

But I mean this is going on in every market, with every borrower around the world. I do not think that they (the Soviets) intentionally misinform you. I think that they may have other bids that may be lower, and so they try to get you down on price to meet your competition. But they know that factors other than just price are important, and for a

variety of reasons they will prefer your product line or your bank compared to somebody else's bank.

Very intensive negotiations, yes, indeed, and probably the most intensive I have ever had anywhere in the world. But I myself do not call that whipsawing.

WILLIAM KOLARIK: So they try to whipsaw, but your view is that they often do not succeed.

ALFRED WENTWORTH: I think, as a matter of fact, they probably do themselves some damage. Some people may go in at a price higher than they would normally go, and I am not at all sure that they get the best price through this intensive type of negotiation.

I think everybody goes into Eastern Europe in particular with the idea that we do not have a willing buyer and a willing seller. You have a very willing buyer who tries to squeeze the seller, and I think many of the American companies and West European companies go in and quote at a higher price so that they can give up a bit and come out whole. So it may be to the East Europeans' disadvantage to attempt to whipsaw.

WILLIAM KOLARIK: Let me pose this question: Is it the feeling here that whipsawing is not unique to East European markets, particularly the Soviet Union? Is it a phenomenon that generally is faced in most international markets? Does anybody want to address that?

ARTHUR DOWNEY: How about reversing that? Is there anybody who feels it is unique?

ANDREW BECK: I would say that perhaps the Soviet FTOs are more experienced negotiators than a lot of other customers in the world. It almost seems sometimes that they go to a negotiating school before they take the job.

JEROME OTTMAR: We have got some American customers that are worse.

LEWIS LAMM: The thing about it is that they are very uniform negotiators, and you can anticipate exactly what they are going to say next. Whipsawing is only a problem for the salesman who goes there and is not willing to go away without an order; because you never lose money on an order you do not get.

ERSKINE CHAPMAN: This question has come up several times during the history of this committee, and in every single instance the majority of the views expressed is that whipsawing is not a factor and is not a problem. It is a common practice throughout international trade. Yet, somehow or other, it insidiously keeps coming back up for review. I do not know why this is; but I am very, very concerned and frightened, quite frankly, to see the GAO recommendations and to think that something of this type is circulating and could generate that kind of thinking within the Government. It frightens me to death, and I wonder what it

will take to get this thing to bed and keep it in bed, and is there anything this committee can do in that direction?

ARTHUR DOWNEY: I would just like to comment on that for a second, and to address briefly the point that Bill Kolarik made before, that there has been no dissent to that portion of the GAO report. In fact, before Bill arrived with us, we received a draft of the GAO report and spent 4 or 5 hours with its drafters. We told them that their conclusions were wrong and that they ought to go back and start all over. We said that there was no evidence for such statements and the extrapolations from them. They rejected our advice, along with similar advice on lots of aspects of the report.

The problem is that this report has appeared in draft, and then in final, and there were hearings on it, and it is still circulating. I have seen businessmen who are only now reading it, and so it is spreading still. This is one of the reasons why we insisted on including whipsawing on the agenda for this meeting, even though some of you were resistant to this. We thought we would have a thorough airing of it, so that we could speak with the benefit of your formal advice on the subject.

ERSKINE CHAPMAN: Well, please understand that I was not questioning its being brought up here. I think it is very important in view of the GAO report. I was really asking where the momentum is coming from that has led to the GAO report, and what can we as a committee do to counteract it?

ARTHUR DOWNEY: Well, perhaps we can discuss that question after we finish the substance of the topic. One option we have been thinking of is to prepare a monograph of some kind for wide distribution based on the conclusions of our own research and the committee's advice.

JEROME OTTMAR: I think we are just dignifying something that is nonexistent by talking about it, and it is so clearcut that I think we should take this and find a way of burying it. And I think this committee can do more good by trying to do that effectively than to talk about it. Whipsawing just ain't so!

WILLIAM KOLARIK: I might mention that in the course of my research, I have talked to businessmen about whipsawing, and almost universally they have concurred with what you have said here today.* But I find that when I ask if whipsawing is a problem there is a tendency among businessmen to say, "no, it is not a problem," and that is all they want to say about it. So, perhaps this reluctance to discuss why it is *not* a problem is one of the reasons why the GAO report has gone on so long without having any effective criticism of it.

WALTER GALENSON: I think it would be a big mistake for this committee to just say there is no problem and let it go. There *is* a prob-

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* See Appendix.

lem. And I think the quicker the committee gets around to doing something about it, the better from our point of view.

Now, I talk to a quite different set of people than you businessmen do, and for the people I talk to it is a real problem. It is a persistent problem, and it is not going to go away because some individual firms say they are doing business and they have no complaints.

Now, look, whenever someone says the United States Government should get involved and help control trade with the Soviet Union, business people who are making profits on this trade say, "Nonsense, why should they?" On the other hand, the people I talk to say, "Okay, why should Eximbank finance it? Let the Government stay out completely and let the private banks do the financing." Well, you say, "No, that puts American business at a disadvantage." So you want help from the Government on financing, but you do not want the Government to get involved in regulating trade.

Now, that creates a problem in the minds of lots of people. If the Government is going to put the money up or guarantee the money, why shouldn't the Government have some say in the terms of trade? That is one of the crucial issues, and you are going to find it of concern up on the Hill.

I think a lot of the problem comes from the fact that we do not make distinctions between what economists call the macro and the micro aspects of the problem. By micro I mean the individual firms dealing with the Soviet Union. It might very well be that everyone around this table is doing well in dealing with the Soviet Union, but it might also be that in the aggregate we are not doing well as a nation because of these dealings. For example, suppose you were dealing with individual firms in the Soviet Union, individual enterprises rather than with a monopsonist. Do you think that they would get as good a deal? What would your profits be if you were dealing with a decentralized economy with private firms as against dealing with a government? That is an issue.

I think the Soviet Union, by the way, is a special case. Among the people I talk with, the only time the issue comes up is with respect to the Soviet Union, not with Eastern Europe and not with China; and the reasons are perfectly obvious. It is a political problem; it is a military problem; it is a competitive problem. And it has got to be put on a special footing. I think you must recognize that.

Another big issue is the fact that the Soviet Union does not have to devote large amounts of R&D (research and development) money to develop the things they can get on license or by direct purchase of products from the United States and from other Western countries.

In a letter I recently sent to the committee, I cited a statement by Tony Crosland, the Foreign Secretary of Great Britain, who unfortunately died recently, in which he said that from the British point of view this

is a problem. In fact, he called upon the Western nations to do something about it in concert. He was speaking just precisely about this problem, this macro problem as seen from the point of view of the public interest as against the profitability interest of the individual firm.

Now, economists always say — and this is theoretical, and you pointed that out before — that if competitors deal with a monopsonist, the monopsonist comes off better. I think that is the basic source of the problem, and every once in a while the public image of this thing is reinforced by some spectacular event, such as, for example, the negotiations over the Olympic Games. Everyone who read that said, "Aha — typical of the way trade is carried on with the Soviet Union!" For the Montreal Olympics we dealt with the Canadians — I guess with the Canadian government — but that was a more open process. Here we are dealing with the Russians. They are playing off ABC, CBS, NBC, against one another and the United States is going to pay three times as much as if we had a consortium of television networks to deal with the Soviet Union.

I think this committee, and I think perhaps the Bureau, too, has been remiss in not devoting a lot of careful analysis and study to this question. The Olympics is a very good example. Why should the people of the United States pay $100 million to view the Games when they could be paying $25 or $30 million? We are strengthening the Soviet economy to that extent. Should we do it? If we have $75 million to throw around, why not give it to some LDC? Why give it to the Soviet Union?

Now, that is what I hear as against what you hear, and that is what makes this a hot issue; and I think you have got to face it.

Thank you.

ARTHUR DOWNEY: I would suggest that since you have raised a whole array of issues, from military to financing to the distinctions between the Soviet government and the Canadian government, you might want to debate these questions selectively. Otherwise, I am afraid we will range pretty widely.

ROBERT MCMENAMIN: Well, I think that the key issue here is, number one, how do we feel about this, and number two, what do we propose to do about the issue of whipsawing? At the very end of Walter's comment he said that we should get into it and study it, and I think that is exactly what we are doing — what Bill Kolarik's discussion paper has done, what the question and answer exercise has done, and what the discussion will now do.

I do not know whether we have the time to get into and break down so many issues. We are business people. We are interested here in the experience of business people in negotiating and doing business in the Soviet Union and other socialist economies. I believe the consensus has been that the issue is way overdrawn and exaggerated.

ARTHUR DOWNEY: For my part, I just think that one question many of us have is how come this issue is still around when we all thought it was gone. Now, we have just had an example of the opposite view, as you put it (referring to Walter Galenson), with the people that you talk to; this is their concern. I am not quite sure who that community is, and you might want to identify it.

But I think you have an issue drawn here. You have had two sides expressed, and we can, if you prefer, just leave it that way. I would prefer to have some more discussion. It depends on you (referring to Robert McMenamin) and your committee though.

ROBERT MCMENAMIN: Let us get the committee talking.

KENNETH LIPPER: It is ironic that the United States finds itself — at least certain people speaking for the United States — find themselves in a position of attacking what has always been characteristic of a free market system, where everybody has an opportunity to get the best deal for himself by a free and open negotiation.

Now, contrary to Walter's comment that the television example is typical — although, frankly, if a television network is willing to pay $100 million, it probably means that they believe they can get $110 million in advertising revenue out of it. And the Soviet Union cannot be blamed for trying to get the maximum value for the product which it sells. But that example really is not even typical of the type of negotiation that we are really engaged in with the Soviet Union, because in this instance they do have a genuinely unique product — namely the Olympic Games — which is not duplicable anywhere else in the world for that moment. Most of the transactions involving the U.S.S.R. deal with tractors, or computers, or copper fabrication equipment, where the whole world is your market. And, frankly, in terms of the market power it brings to bear on a particular company, in reality the Soviet Union represents a pittance to most of the companies it is dealing with, versus probably one or two customers in Germany, or France, or England or anywhere else.

So the irony is that in this case the Soviet Union is being viewed as some kind of a huge superpower economically vis-a-vis International Harvester or General Motors, or anyone else, simply because it has 250 million people and a lot of land, and is buying a few trucks, when in reality General Motors has so many bigger customers — both private firms and government-owned operations in the Western countries — where they are really doing the bulk of their business. So, if anyone has the market power, it is General Motors which can say, "Look, I do not like the deal; I am going to walk away."

The whipsawing argument is so fallacious that it is hard to attack other than on a practical basis; that American companies are not in business for charity.

ARTHUR DOWNEY: It seems to me that you disagree (with the whipsaw theory). Is that what you are saying? (Laughter.)

DONALD STINGEL: I think it is a case of preparation. I think that the FTOs are well-prepared. They have investigated your company and your competitors, and maybe we have not done as well in doing that sometimes. When we go in, we have to know how bad the FTO wants our product or our service, and we have to know what our competition is as well as the Soviets know it; then we can hold out for our price or walk away. And we have that free choice.

But again, I think sometimes we get a little bit over-anxious, and we let them scare us because they are dealing from a central, well-organized stance. But I do not think whipsawing really is any more than you against the FTO, and if you want to be strong and be well-prepared, you can do well in your negotiations. If you are not, you are going to lose the job or you are going to get it at too low a price.

G.M. GARBARINO: We have had the same situation in Europe and other parts of the world dealing with nationalized industries. In France, EDF, the big nationalized electrical group, SNCF (the French National Railroads), and we also have the same situation now with nationalized oil companies like ENI in Italy, as well as with the OPEC oil cartel. So I think that we have to learn to live with some of these things, certainly OPEC. But nationalized industries, that is an old story.

WILLIAM KOLARIK: I would just like to address a remark that Walter Galenson made earlier. In discussing whipsawing, you referred to political, military, and economic concerns. But I think that one thing I should point out is that if you carefully read the GAO report and the sections on the imbalance of commercial benefits, you will see that they draw many of their conclusions from the economic consequences of whipsawing; that is, the shaving of profit margins.

So, my own view on this is that if the committee is to address whipsawing, I think the first place to attack it would be on this matter of corporate profitability and profit margins.

WALTER GALENSON: Just a couple of comments. In the first place, export-import is not a free market system. Everyone says well, we believe in the free market system. But in export-import, we are getting away from the free market system. So let us not go back to old shibboleths and say we believe in operating in the free market system.

Second, as far as size——

JEROME OTTMAR: What does that mean? Why don't you explain that?

ALFRED WENTWORTH: Explain that, Professor.

WALTER GALENSON: The point is that you are getting government support.

ALFRED WENTWORTH: Where? In Russia? From Eximbank? Where?

WALTER GALENSON: Well, you would.

ALFRED WENTWORTH: Who has gotten it in years?

WILLIAM FLEMING: All we care about from the Export-Import Bank is one thing; that we can equalize our position vis-a-vis the Germans, the French, the Italians, and everybody else. We do not want to sell the product on financing. One sells it on price and quality, not on financing.

WALTER GALENSON: I understand that, but the Germans and the Japanese have abandoned the free market system to that extent (in financing), and you want to do the same thing. It is perfectly clear.

WILLIAM FLEMING: What do you mean they have?

WALTER GALENSON: Because they are offering government assistance. The British have offered a billion dollar line of credit to the Soviet Union.

WILLIAM FLEMING: If somebody gave you a 6 percent mortgage on a house and everybody else was offering 9 percent, you would take it.

WALTER GALENSON: My only point is that we are not operating in this world on a pure market system. We have not been for a long time. Another thing, in terms of GNP the U.S.S.R. is the second largest economy in the world; it is not just a place that buys a couple of trucks. So you are not dealing with small potatoes. This is a very big, powerful outfit economically.

KENNETH LIPPER: Are you talking about the country or the amount they are buying?

WALTER GALENSON: The country.

KENNETH LIPPER: But the whole question is what they are buying.

WALTER GALENSON: I know. They are limited in what they can buy essentially because of credit at the moment. But the one thing I did want to talk about is where I hear arguments supporting the whipsaw theory. I do not talk to businessmen very much; that is very obvious. (Laughter.) I do talk to academic people, I talk to government people, and above all, I have been talking to some of the people in the labor movement.

Now, some of you may remember that we had the late Nathaniel Goldfinger (of the AFL–CIO) up here at one of our meetings, and he presented their view very precisely, succinctly. A lot of you took out after him, I recall. It was a very heated and interesting discussion. But they have a very deep-seated view of these things. They are as interested in jobs as you are, I assure you. And if you are going to prevail, if you are going to make your views overriding, if you want to get MFN, if you want to get Eximbank financing, you have got to take this sort of thing

seriously, because a lot of people and a lot of influential people feel this way.

Of course, I do not talk to everybody, but neither do you. I think that is clear.

ROBERT MCMENAMIN: I would think that there is no question that we are all taking it seriously. And we can thank Art (referring to Arthur Downey) and the others on his staff for making us review it again, although some of us felt, like Erskine Chapman, that we had put it to rest before.

However, let me say this. I think that the most important thing we can say is that the people around this table represent companies that are doing a very, very important part of the business being done with the Soviet Union, and I have not heard a single businessman who has said that whipsawing is a problem.

Now, if there is one, then he should say so, and somehow the collective opinions of this group must be referred to people who hold a contrary view so that they can be considered. I would like to hear from Art later as to how that might be done. I will field some questions here.

ERSKINE CHAPMAN: Bob, I wonder, with all respect to Walter (referring to Walter Galenson), if maybe we in the business community have not narrowed this whole question down to the finite matter of negotiating a deal. Walter is giving it a much broader context than that, and if that is what he is really attempting to do, I think we would all agree that we recognize there are other questions, and that there are segments of U.S. society that have questions about the whole issue of trade with the Eastern bloc. I think, Walter, our difference here is that we are looking at a very small definition of whipsawing, and you are bringing in a much wider definition to the term. Is that correct?

WALTER GALENSON: Yes! I am emphasizing macro considerations rather than micro.

ERSKINE CHAPMAN: So I guess the question is which aspect we are discussing.

ARTHUR DOWNEY: All right. I think we do want to narrow the focus, because what we have been talking about, and what the discussion paper talks about, is the narrow question of whipsawing. You suggested, Walter, that in theory, when a seller is up against a monopsonistic buyer, the seller loses. He does not make a profit, or he makes less of a profit.

All right. Now, that is a narrow question, and I think we have a group here that can suggest whether or not the practice is the same as the theory. Is there anyone who feels that this theory is correct?

ERSKINE CHAPMAN: I can suggest that it is not correct, and I think we could get some agreement around the table, because I think many of the companies represented here sell at greater profit to the So-

viet Union, in some instances at least, than they do in other markets around the world.

ARTHUR DOWNEY: Well, let us just narrow it down to this question. Is there anybody who feels that they have lost money or have sold for a substantially lesser price in the Soviet Union as against their other foreign trade?

(Silence.)

All right. So (referring to Walter Galenson), the concern that you expressed, drawing from the theory that American companies are being taken over the coals, does not prove out, at least in this sample, which may not be representative.

Would you accept that point, Walter?

WALTER GALENSON: I accept it, of course, but I still would like to see the profit and loss statements on the company divisions around the country that do business with the Soviet Union to see whether, for example, you can do just as well in dealing with the Soviet Union as with LDC's or with the Common Market or with Japan. If so, it is a very interesting point and an important point. If you can really document that——

ROBERT MCMENAMIN: But by raising the question you are rather questioning the honesty or sincerity of our opinions here.

WALTER GALENSON: You know, it is one thing to ask businessmen for an off-the-cuff opinion. It is another thing for someone to do a careful study of this. That is the point I am making.

ROBERT MCMENAMIN: I think most of us who are giving an opinion have looked very carefully at individual contracts. I know we (at International Harvester) do. If there is anyone who does not do so, they are not really following the profit maximizing principle of the free market theory.

GEORGES POTTER: None of us here would do otherwise.

ROBERT MCMENAMIN: So, we have had an expression now that there is no appreciable negative effect of negotiating deals with the Soviet Union as a result of the way these deals are negotiated.

ARTHUR DOWNEY: You had a secondary question, I think, implied. The first one was with regard to profit — and I think we have now suggested that the practice varies with the theory on how much you make. I think another part of it, a part that is common to people in the labor movement and others, is that while you may make as much profit as elsewhere, you tend to lose in other ways — lose markets, create competitors, things like that — in dealing with a monopsonistic buyer.

Is that another facet of it?

WALTER GALENSON: Yes, of course.

ARTHUR DOWNEY: Do any of the businessmen here feel that these other concerns are a threat to them? (Silence.) All right. On these other

points, then, I think we again have a variance between the generally held theory, and the viewpoint of the business community as represented here.

ROBERT MCMENAMIN: Well, we have got the expression of opinion we need, and if somebody can add to it, let them do so; but then we have got to address the point of what do we do about this issue.

ANDREW BECK: I think you may have a situation here where at this table you are looking at a group of businessmen who are reasonably well-experienced in foreign sales and in foreign trade. And I think I know what might have happened in the case of the Soviet Union. A few years ago, the East-West business had a certain amount of glamour, and there were, I think, a lot of companies that should have never gotten into it; and I think these were the ones that went up against the Soviet FTOs and took a beating. Perhaps this is where this whole thing was generated from.

WILLIAM KOLARIK: I have found something similar in my research. It seems that most companies generally have two responses to whipsaw tactics. They cope with it, they adjust, they gain experience with it; or they turn the backs on the Soviet market, and they just do not bother with the U.S.S.R. again.

Now, have any of you heard of the latter occurring, particularly with companies that perhaps were initially entranced in 1971 and 1972 by the glamour of the Soviet market?

ARTHUR DOWNEY: Or any of the socialist countries?

WILLIAM KOLARIK: Or any of the socialist countries. Have you heard of companies, perhaps inexperienced in international trade, which went into the Soviet market in a rush, and subsequently were turned off by the experience.

ARTHUR DOWNEY: As contrasted with going to the Middle East or some other new market.

G.M. GARBARINO: I think the key point that has been made is that these people probably were inexperienced in international trade. And what they are running into and have been disenchanted with in the Soviet Union, they would have run into in many other international markets.

ROBERT MCMENAMIN: Yes. And it is hard, I believe, to separate this form of disenchantment from their disappointment when they realize that the size of the market for hard currency purchases is quite small. The market is not all that big. It is less than a billion dollars for U.S.-manufactured goods, and when you spread that between various industries, it is not so large.

JEROME OTTMAR: I would like to make one other point. I would love to have the help of the GAO or any other government agency to help me make 5 percent more on a contract, but they are not going to do that until they get control of industry in Italy, England, France, Ger-

many, Japan, et cetera. And I do not think that the GAO, which I thought was made up of a bunch of accountants — they are apparently commercially minded — is in international business and understands it.

I hate to be facetious, but I think it is as simple as that. The academic approach or the GAO approach just does not work.

ROBERT MCMENAMIN: I believe we have a question or comment from the floor.

VALENTINE ZABIJAKA: I have a question.

ROBERT MCMENAMIN: Who are you, please?

VALENTINE ZABIJAKA: Val Zabijaka, Bureau of East-West Trade. My question is, what does this panel represent? What kind of companies? Are they much different from the companies sampled in Bill Kolarik's research?

ROBERT MCMENAMIN: I think we can ask Bill to answer that. Do you see any difference in the complexion of this committee and the complexion of the participants in your research project?

WILLIAM KOLARIK: Well, off the cuff, I would probably say that there are perhaps more large companies represented here today than were represented in my interview sample; but I do not notice any substantial difference of opinion on whipsawing. Even among the medium-sized companies that I interviewed, it seems that they did not have a significant difference of opinion on this issue.

Regarding the composition of my sample in other respects, I tried to include high-technology companies dealing in exotic products — like semiconductors and computers. And I tried to include some companies that were dealing in fairly conventional technology, such as standard foundry equipment or machine tools. So, I tried to balance the sample according to company size, product sectors, and level of technology, as well as a number of other variables. These factors did not appear to have much impact. On this issue of whipsawing, there was not a real difference of opinion. What has been said is consistent with what I have heard from businessmen I have interviewed and had correspondence with in the past.

ROBERT MCMENAMIN: Another question from the floor.

DAVID JONES: I am not a member of the committee, but I am sitting back here sort of beside myself.

ARTHUR DOWNEY: Will you identify yourself, please?

DAVID JONES: Yes. My name is David Jones. I am an attorney and a businessman from Philadelphia, and I would say that about 95 percent of my activity is in Eastern Europe. I am certainly one of the few Americans, and maybe the only American, who has ever served on the negotiating staff of a socialist FTO. And I have sat on the negotiating staffs of, I would say, possibly half a dozen Polish FTOs through several dozen

contracts certainly, primarily with small American and Canadian companies that I would think would be most vulnerable to these practices.

I have never heard the word mentioned. I have never heard the practice mentioned. I do not think it exists. Certainly, preselection, yes. Very hard, very exhausting negotiating, yes. Whipsawing, I do not think so.

Thank you.

ROBERT MCMENAMIN: Thank you. It is nice to hear from a new voice. Well, I think the answer has come through today loud and clear that the whipsaw problem has been exaggerated, and that the business community is not asking for help in this area.

GEORGES POTTER: There is one point I wanted to make, Bob. I think the Government has and should do more as far as logistical support is concerned, but that is quite a different subject from what we are talking about.

ARTHUR DOWNEY: Yes, we discussed that all morning regarding Bureau help to companies stationing personnel on-site in Eastern Europe.

ALFRED WENTWORTH: Mr. Chairman, GAO positions on some issues have troubled me in the past. It seems to me they are pretty wide-ranging, as Jerry says (referring to Jerome Ottmar), and I think I would like to suggest that this committee respond to the GAO report as a group. It is high time they heard from the practical side, it seems to me.

Now, how that can be accomplished, I do not know.

ROBERT MCMENAMIN: All right. Then I would like to suggest that we consider the idea put forth by Alfred Wentworth that a reply be prepared for the General Accounting Office.

[There followed a lengthy discussion on what action should be taken by the committee. A consensus developed among the members leading to the recommendation that a monograph on whipsawing be prepared by the Bureau of East-West Trade from a transcript of the preceding discussion, and that the Bureau should also prepare a brief summary of the proceedings. The committee also asked that these materials be distributed widely, and be forwarded to the General Accounting Office. Then, to give all committee members a final opportunity to express their views on whipsawing, Dr. Lenz of the Bureau asked for additional comments. After insuring a complete record, Dr. Lenz turned back the proceedings to Chairman McMenamin.]

RESUME DISCUSSION BY ROBERT MCMENAMIN: We have two things we have decided to do. One is to boil down a statement here that will go forward to Deputy Assistant Secretary Downey for transmittal. The second is a transcript of this meeting, and I believe it is the consensus of this meeting that a monograph will be prepared based on the transcript of today's meeting.

DONALD STINGEL: Bob, could we also point out in the monograph that the dissent seems to be academia, the assent seems to be business.

ROBERT MCMENAMIN: Yes. There appears to be a difference in the point of view from those of us who are in the business sphere as against those who are in the university element.

WALTER GALENSON: Just for the record, I would like to say that I do not necessarily dissent. I am trying to explain what the problem is. Now, if I and the people I speak with could be assured that trade with the Soviet Union is no less profitable than trade with other countries, and that trade with the Soviet Union is not somehow working to the advantage of the Soviet Union in terms of allocation of its resources—

ARTHUR DOWNEY: That is a different question.

WALTER GALENSON: All right. Let us stick to the first one. That is a very important conclusion, and one which I have never seen established.

ARTHUR DOWNEY: Would they be prepared to accept not only the evidence of everybody assembled here, which they might feel is not persuasive because we are a small group and possibly not representative, but would they be prepared to accept the results of Bill Kolarik's scholarly study?*

WALTER GALENSON: I would think so.

ARTHUR DOWNEY: Would you take it upon yourself to try to convey these views to that community and the results of Bill's study?

WALTER GALENSON: Certainly.

ARTHUR DOWNEY: Walter, may I also suggest that you report back after you convey this information to labor and other members of the community to whom you talk, and see what reaction you get. Invite them to come.

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* See Appendix.

Appendix

Attitudes And Opinions Of American Businessmen On Issues Of Soviet-American Commerce

by
William F. Kolarik, Jr.

William Kolarik joined the staff of the Bureau of East-West Trade in January 1977. Prior to that time he was engaged in Ph.D. dissertation research at Kent State University. As part of this research, funded by an International Studies Association Fellowship under a grant from the Ford Foundation, Kolarik surveyed and interviewed over 200 U.S. businessmen on a wide range of U.S.-Soviet trade issues. A report summarizing research results was obtained under contract by the Department of Commerce, and portions of that report pertinent to whipsawing are represented here with the permission of the author.

Attitudes And Opinions Of American Businessmen On Issues Of Soviet-American Commerce

This report summarizes portions of data collected for a larger research project, the purpose of which is to assess views of American businessmen on a wide range of issues of U.S.-Soviet trade and detente. Both the parent study and this paper focus on a specific category of company officials who have been personally involved in Soviet-American commerce. For convenience, these businessmen have been labeled Soviet Area Executives. More precisely, a Soviet Area Executive (SAE) is defined as a senior corporate officer, stationed in the United States, who has exercised prime responsibility for his company's existing or prospective business with the U.S.S.R.

Hence, the object of the study is the "U.S.S.R. man" in the top management of all those American firms which, since the inception of detente (1971–72), have made significant efforts to establish direct business ties with the Soviets. Companies which have had only indirect contacts with the U.S.S.R. through an intermediary (e.g. foreign-based personnel, agents, or via business subcontracted by another U.S. firm) have been excluded from the study.[1] For reasons of policy analysis, the blurring of a firm's national lines and/or the insulation of company headquarters from face-to-face contacts with Soviet foreign trade representatives were deemed unacceptable.

Hopefully, an inventory and analysis of the opinions, attitudes, and expectations of Soviet Area Executives of U.S. corporations will make a meaningful contribution to our understanding of Soviet-American relations in the 1970's. Certainly the views of these businessmen are important for their possible impact on their firms' policies toward Soviet-American trade. In addition, because many of these executives have had direct contact with Soviet science and technology, and since they help to form an important constituency relative to U.S. foreign trade policy, their views should be of substantial interest to government officials, business specialists, and academic experts.

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[1] On many issues, important differences in viewpoints have been found between home office personnel in the U.S. and their foreign-based marketing staffs. See Thomas A. Wolf, "Industry Problems in East-West Trade," unpublished manuscript, Department of Economics, Ohio State University, February 1975.

Background

In 1974 an initial background study was compiled to provide a foundation for the project.[2] Subsequently, a preliminary survey of Soviet Area Executives was conducted by mail during the summer of 1975.[3] This analysis is based on initial interpretations of a second and more detailed survey and followup personal interviews executed during the summer of 1976. The goal of the following text is to highlight the viewpoints of Soviet Area Executives on some of the more controversial and critical policy-related issues vis-a-vis the future of Soviet-American trade.

Method[4]

Survey Procedure

Companies: A primary procedural objective was to obtain a representative sample of American companies which have recently explored business opportunities with the Soviets. The term "American company" refers to a firm headquartered and incorporated in the United States. As of this writing, the most comprehensive available inventory of such companies is provided by the Washington Forum, Inc., which furnished upon request a list of 550 relevant firms.[5] This list was composed in its latest form in September 1975. Consequently, throughout June of 1976 an effort was made to update and cross-check Washington Forum's work. This was accomplished by intensive examination of publicly available information as far back as 1972 (e.g. *Wall Street Journal, New York Times,* trade publications), and through telephone canvassing of the public relations officers of all companies on the updated list. Following these

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[2] William F. Kolarik, Jr., and Robert W. Clawson, "The Businessmen: Soviet and American Trade Actors," paper presented at the Central Slavic Conference, St. Louis, November 8, 1974.

[3] Robert W. Clawson and William F. Kolarik, Jr., "Soviet-American Commerce: Trade Actor Attitudes Toward National Security, Cost-Benefit, Moral and Operational Questions," paper presented at the Annual Meeting of the American Association for the Advancement of Slavic Studies, Atlanta, October 11, 1975; William F. Kolarik, Jr., and Robert W. Clawson, "American Corporate Response to Soviet Foreign Policy: The Economics of Detente," paper presented at the Central Slavic Conference, Lawrence, Kansas, November 7, 1975. For a summary of the above data, see Clawson and Kolarik, "Surveying U.S. Businessmen Engaged in Soviet-American Trade," Association for Comparative Economic Studies *Bulletin,* Summer 1976, pp. 71-81.

[4] The following discussion is intended as a methodological sketch. For more detailed information on approaches and techniques used in this research project, see Robert W. Clawson and William F. Kolarik, Jr., "Trade, Technology and Soviet R&D: U.S. Corporate Executives' View," paper presented at the Annual Meeting of the American Association for the Advancement of Slavic Studies, St. Louis, October 8, 1976.

[5] Washington Forum, Inc., is a research organization which provides information services to institutional investors.

procedures, the list was initially cut to 411 companies. A number of additional measures to insure an accurate sample resulted in a final survey population of 386 relevant firms.[6] Each of these firms was mailed a questionnaire directed to the appropriate corporate executive officer.[7]

Executives: In order to generate meaningful results, the survey also required a representative sample of top corporate executives whose responsibilities are relevant to business with the Soviet Union—i.e. it was necessary to pinpoint the "U.S.S.R. man" in each company.[8] To achieve

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[6] For purposes of this research, a "company" was defined as a business entity capable of making major marketing decisions on an independent basis. Corporate autonomy was a key factor in selecting companies for the survey population. Telephone canvassing enabled the analyst to pinpoint within corporate conglomerates the specific subsidiaries which have explored the Soviet market. Where it was apparent that the central headquarters of the corporate parent was allowing subsidiaries to operate in the Soviet market with virtually a free hand, each subsidiary was considered a separate company for sampling purposes.

Conversely, when it was evident that Soviet business activity throughout the conglomerate had been closely controlled and coordinated by the central headquarters staff, the parent company was retained in the survey population while affiliates were crossed off the list. Where the parent company *and* a subsidiary had explored Soviet business—but independently of one another—both were retained in the survey population.

[7] Selection of questions for the survey was guided by findings of the earlier survey and background research. The final questionnaire consisted of 84 variables, divided into two categories: Sixty-four attitudinal items, and 20 objective inquiries (e.g. age, corporate income).

[8] Because of the bewildering proliferation of unique titles within American business, senior executives of U.S. corporations were categorized using the following occupational roles:

A. *Ultimate Senior Executive:* This designation typically describes either the President or Chairman of the Board. In some cases, this classification also may include the "division manager" (in General Motors, for example). It designates a top decisionmaking rank. Also included within this category are positions such as General Manager, and Executive Vice President.

B. *Senior International Executive:* This category designates a top company officer who is charged with devising or managing international programs. Most often, such executives hold a title such as Vice President-International; though occasionally with large firms "U.S.S.R. VP" or something similar is used. They often have a "sales" orientation.

C. *Senior All-Purpose Executive.* This category is usually marked by the title of Senior Vice President, but also includes simply VP's without portfolio. These men are usually generalists who may be charged with looking into the possibilities of entry into international markets along with a score of other duties. Also, they may oversee the actual development of such new programs.

D. *Senior Operations Specialist.* In many firms, the operational end of Soviet or other "exotic" marketing is handed over to a Project Manager, Group Vice President, or someone with a similar title indicating that he is either a product specialist or responsible for coming up with new ideas and developing concepts. In any case, this category describes executives who are charged by the nature of their other specialty with getting into the international market. Those holding the title of Sales Manager also were included in this group.

this goal, inquiries were made during telephone canvassing to find out the name, position, and mailing address of the ". . . senior executive in your company who is currently handling your firm's business relations with the U.S.S.R." The questionnaire designated for each company was then addressed to that individual.

Response: As a result of the mailing of the survey in mid-July 1976, and subsequent followups, a total of 203 responses were received. This represents a 52.6 percent response rate for the 386 companies in the final survey population. By accepted standards of survey research, this is an extremely high return rate for a mail questionnaire.[9]

Personal Interviews

During August-September, 29 personal interviews were conducted nationwide with a sample of those Soviet Area Executives who had responded to the survey. This group was not intended to be a scientifically selected random sample. Rather, the primary purpose of the interviews was to acquire added insight into the more structured data accumulated from previous surveys and background research.

The interviews themselves were relatively unstructured question and answer sessions that lasted an average of 1 hour 45 minutes.[10] During each session the interviewer pursued three interrelated objectives: (1) To stimulate the participant to elaborate freely on his views, thus supplying illuminating details. (2) To clear up evident paradoxes in the data already collected. (3) To gain new data through verbal replies to open-ended oral questions. Such information is vital and could not be secured in any other way. Finally, personal interviews also proved valuable for the acquisition of various important psychological intangibles which are impossible to glean by other methods.[11]

Before reporting research findings, a major qualification is in order: Attitudes and opinions expressed by participants are their personal observations and do not necessarily represent official company policy. Nonetheless, these executives are strategically placed to influence such policy.

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[9] The author knows of only one other comparable mail survey that has achieved a higher rate of return. Russett and Hanson achieved a response rate of 54 percent for their mail survey designed to ascertain the foreign policy beliefs of American businessmen. See Bruce M. Russett and Elizabeth C. Hanson, *Interest and Ideology: The Foreign Policy Beliefs of American Businessmen* (San Francisco: W. H. Freeman & Co., 1975), pp. 61-64.

[10] While "relatively unstructured," interviews were not free-style conversations. During each session, the interviewer worked off a prepared question and answer sheet which insured that certain matters would be brought up in a methodical manner and that all answers would be recorded properly.

[11] Executives were selected for interviews according to such variables as company size, type of business, geographical accessibility, level of company technology, and as to whether the company had concluded a scientific and technical cooperation agreement with the U.S.S.R.

Has U.S.-Soviet Trade Been Profitable or Unprofitable for American Business?

Seventy-one percent of all executives responding to the survey evaluated their companies' experiences in the Soviet market as profitable. Thirty-one percent "agreed strongly" that their companies had made money while 39 percent agreed but "not strongly." Next, for a variety of reasons, 10 percent indicated that they were "not sure" whether or not company business in the U.S.S.R. had been profitable.[12] Another 9 percent disagreed that their companies had made money but "not strongly." These executives appear to represent a group of somewhat discouraged firms which have invested executive talent and money in Soviet business efforts over the past 2–3 years without receiving any returns as yet. Finally, a small minority of 10 percent who selected the "disagree strongly" category apparently represent companies which have lost significant money on their first Soviet contract(s). From personal interviews, it seems that this latter group is primarily made up of firms which were inexperienced in, and unprepared for, the Soviet market.[13]

In summary, survey data strongly suggest that, on the whole, Soviet foreign trade organizations (FTOs) thus far have not financially exploited American companies which have actively pursued business with the U.S.S.R. In view of the fact that the Soviet Union is basically a new market for most firms, the record for U.S. companies engaged in Soviet-American commerce appears to be at least as successful as for similar efforts in other growth markets around the world.

To What Extent Are Soviet FTOs Able To Whipsaw U.S. Companies Effectively?

Various analysts have concluded that because Soviet FTOs are national purchasing monopolies, they possess inordinate market power — enabling them to play off (i.e., whipsaw) prospective sellers against one

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[12] The 10 percent who were "not sure" whether or not company business had been profitable can be subdivided into three groups: (1) Those whose companies have lost a small amount of money or broken even on their first deal(s) with the Soviets and have been promised or are anticipating more profitable contracts in the near future. (2) Corporate subsidiaries or divisions which operate autonomously in making major marketing decisions, but let the parent company handle the accounting. In some cases the parent company's accounting system does not include procedures for separating out and evaluating Soviet business. Therefore, the subsidiary does not know with any precision the net profitability of the market. (3) Executives of firms which have recently begun efforts to penetrate the Soviet market, but whose companies have not yet concluded a contract.

[13] See William F. Kolarik, Jr., "Executive Viewpoints on U.S.A.-U.S.S.R. Commerce: A Preliminary Analysis," *International Studies Notes*, Vol. 3, No. 4, Winter, 1976, pp. 22-27.

another to obtain maximum contract concessions.[14] To what extent is this contention consistent with collected survey and interview data?

Survey results and personal interviews suggest that while Soviet FTOs have considerable theoretical potential for effective whipsawing, in practice this potential often goes unrealized. If American firms are in fact helpless or seriously disadvantaged at the bargaining table, this is not reflected in the data collected.

In reality, it appears that the ability of FTOs to exert leverage on U.S. companies is governed by a complex interplay of variables. For example, as of this writing FTO bargaining leverage in "frontier" areas of the U.S. electronics industry (components and instrumentation) appears to have been reduced to a minimum. The following factors seem to be influential:

(1) Because the value of prospective Soviet contracts generally has been small compared to total company sales volume, the U.S.S.R. has not been viewed as an important customer.[15] Consequently, most executives interviewed indicated a low tolerance level for FTO whipsawing. Use of such tactics has resulted in some firms simply turning their backs on the Soviet market. In fact, because FTOs were viewed as difficult to deal with, at least some of those electronics companies which are pursuing U.S.S.R. business have been charging the Soviets premium prices to cover the comparatively greater costs and risks of servicing the market.[16]

(2) Those executives in segments of the electronics industry highly sensitive to fluctuations in the business cycle seemed willing to devote currently unused production capacity and executive talent to service the U.S.S.R., but were wary of investing in new capabilities for an unpredictable Soviet market. Thus, business uncertainty generated by erratic Soviet foreign trade patterns can contribute to growing reluctance to deal with the U.S.S.R. when firms become less "hungry" as customary markets

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[14] For analyses of FTO "monopoly" market leverage, which should properly be termed monopsony, see the following: Marshall I. Goldman, *Detente and Dollars* (New York: Basic Books, 1975); Glen A. Smith, *Soviet Foreign Trade: Organization, Operations, and Policy, 1918-1971* (New York: Praeger, 1973); Christopher E. Stowell, *et al., Soviet Industrial Import Priorities with Marketing Considerations for Exporting to the U.S.S.R.* (New York: Praeger, 1975); U.S. General Accounting Office, *The Government's Role in East-West Trade: Problems and Issues* (Washington, D.C.: General Accounting Office, 1976).

[15] Survey results show that on the whole Soviet business has comprised only a small portion of total annual corporate business. The median reported was 1.2 percent, with a mode of less than 1 percent.

[16] One executive described his company's experience in the Soviet market as follows: "We usually quote a price 55 percent higher to the Soviets than for our regular customers. We have to do that to make sure we cover the high costs of doing business with those guys."

recover from recession and, particularly, as it becomes necessary to allocate available production capacity to one's traditionally best customers.

(3) Economic recovery in segments of the electronics industry (as of mid-1976) has made the Soviet market especially unattractive for sellers who face intense competition in dynamic high-technology products which are subject to rapid innovation-induced commercial obsolesence. In these circumstances, executives interviewed perceived that even if they could conclude otherwise successful Soviet contracts, enormous opportunity costs would be incurred by tolerating the time consuming business practices of FTOs. Also, because more attractive markets are available once again, the risk of *not* concluding a U.S.S.R. contract and, thereby, completely "wasting sales dollars," becomes unacceptable.

Interview results suggest that these cost-risk factors, not the alleged raw market power of the FTO, have been the immediate reasons for some U.S. electronics companies deciding to stop actively seeking Soviet business. Although the executives of these companies had not actually been subjected to whipsaw tactics, they were strongly opposed in principle to the Soviet method of state trading. Should their companies ever re-enter the Soviet market, they seemed resolved not to put up with whipsaw techniques from what was seen as a secondary customer. Of those companies which are still interested in Soviet business, as was noted above, many are charging the U.S.S.R. premium prices to make worthwhile the increased risks and costs of this market.

(4) Soviet FTOs often place priority on the acquisition of specific types of electronics technology in which the United States has a near-monopoly on world markets. Consequently, an FTO's ability to play off U.S. suppliers against foreign competition is objectively limited.

(5) Within the United States, a number of firms have earned the reputation as world leaders in their respective product lines. Since the Soviets have an easily documented penchant for buying the best, certain firms are placed in an excellent and sometimes even a superior bargaining position relative to FTOs. There is evidence that some of these companies virtually have been able to dictate prices to the Soviets which have earned windfall profits.[17]

It might be argued that those dealing in frontier electronics are not typical of most companies which have explored Soviet-American trade. However, interview results suggest that similar forces are working to nullify FTO market power in numerous product sectors (e.g., in the machine tool industry). This is not necessarily surprising when one considers that 49 percent of survey respondents said that their companies deal in high-technology product lines.

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[17] An executive of one such company stated that: "Our East bloc sales (including the U.S.S.R.) give us our highest profit margin. They never quibble about price."

Other interview data indicate that some analysts may have overstated the negative consequences of FTO market leverage even in situations which are ripe for whipsaw tactics. For example, let us take the case of a company dealing in conventional technology: A foundry equipment manufacturer hard hit by recession and vying with numerous competitors for a large Soviet contract. Executives interviewed who had been placed in this situation indicated that while they might have been whipsawed into break-even or mildly unprofitable deals, these contracts had enabled their companies to avoid layoffs, temporary shutdowns, or even bankruptcy.

Another important point is that executives of many medium-size and small companies in various lines of business often stated that facing a monopoly buyer has not been an altogether unfamiliar experience. To these executives, bargaining with a number of U.S. industrial giants was seen as somewhat analogous to dealing with a Soviet FTO. Likewise, executives in companies of all sizes perceived a similar analogy with reference to the U.S. Government's defense contracting procedures.[18]

In summary, when whipsaw tactics have been used by Soviet FTOs, they have often proven ineffective through noncompliance. Many American companies simply refuse to be strung along. In addition, when dealing with FTOs a number of firms have been able to make valuable use of experience gained with large customers in the United States. The contention that monopsony is completely alien to American businesses which operate in a "free enterprise" environment does not appear to be tenable.

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[18] In a letter to this writer subsequent to a personal interview, one executive summed up his views on FTO bargaining leverage as follows: "I would strongly disagree that the FTOs have any unusual clout. For instance, our own Government's bids are publicly opened and similar bids often repeated in short intervals. This exerts much more pressure on the seller to engage in cutthroat competition. Dealing with the FTO, the seller is in full control of what terms and prices he is willing or not willing to agree to. It is no different than dealing with any large customer."

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